Remarks
As Prepared for Delivery
By

A. W. Clausen, President
The World Bank
and
International Finance Corporation

at the
Diplomatic Seminar Series
Meridian House International

Washington, D.C.
January 29, 1986
Your excellencies, ladies and gentlemen, good afternoon.

This is truly a welcome honor to take part in the Diplomatic Lecture Series here at Meridian House International. I see that many of our friends from the diplomatic corps are in attendance as well as a distinguished group of Americans. This creates an international environment which is at once very stimulating and pleasantly familiar to someone from The World Bank. There are some duties which become tedious in any job, but the opportunity to exchange points of view with an audience as informed, experienced, and diverse as this one...well, that's one sure way to make my day." So, my thanks to you, John, for putting this all together.

And the timing couldn't be better! Rather suddenly the work of The World Bank has found its way to the headlines. Urgent questions are coming our way with greater frequency...and volume. What is The World Bank doing about the enormous debt burdens in the middle income developing nations? What will be The World Bank's contribution to Secretary Baker's proposed international debt strategy? What steps are we taking to combat the threat of future famines in Africa and to end poverty in the poorest countries? What is our view on private enterprise? Will The World Bank use its resources to promote private sector development in the Third World?
These are reasonable questions on which we have been working for some time. I would propose that we address these areas — by looking ahead to the priority issues on The World Bank's agenda. I will be brief because I very much want to hear your thoughts and questions. This should be a dialogue, not a long monologue from me.

First, let us have a look at our most recent assessments of global economic prospects, particularly in the industrial countries. In which direction are we headed? Recovery or recession? Our view at The World Bank is that, while it may prove true that the reasonable recovery of 1984 is petering out, and the evidence is growing that it is, we nonetheless believe that a recession can probably be avoided if the major industrial countries act in a coordinated way to foster their own growth through better economic management. This means that 1986 will probably produce results not much better than the disappointing figures for 1985. And for developing countries seeking expanding markets for their exports, this has to be discouraging news.
It is, however, consistent with established trends. Industrial countries' export growth averaged 5.1 percent a year in the 1960s, then declined to 3.0 percent in the Seventies and to only 2.3 percent per year in the first half of the 80s. Equally troubling is the declining trend in industrial country imports. They grew by 9.5 percent per year in the 1960s, falling to 4.4 percent in the Seventies. Put another way, for every 1 percent increase in GDP, industrial country imports grew by 1.9 percent in the Sixties and then 1.5 percent in the Seventies. Over the last five years, the downward trend in this relationship has continued.

The implications of these trends are grim if not necessarily disastrous. Assuming that industrial countries keep protectionist trade barriers down, (and I'll grant you that is a big if,) then we can foresee that Third World exports will grow. But they will not grow fast enough to furnish these countries with the additional resources they need to pay heavy external debt obligations and to finance domestic investment for growth. And that means that increased levels of external capital must fill part of the gap.

This brings me directly to priority issue number one on The World Bank's agenda -- the highly indebted nations and The World Bank's response to their difficulties. This audience hardly requires an introduction to this issue -- indeed, many of you are deeply immersed in it.
So, you will recall that in Seoul, at our last annual meeting, The World Bank's shareholders (including the United States) reached agreement that the Bank should play an enhanced role in assisting the highly indebted, middle-income nations to move forward on a development path that would secure growth and restore creditworthiness. We are most grateful to Secretary Baker for stressing the importance of a resumption of growth in the highly indebted countries and for placing such confidence in The World Bank as a major participant in the international debt strategy. Our long experience in promoting growth throughout the developing world makes us very willing and, let me say, quite capable partners in this effort.

The new consensus on the debt issue that emerged at Seoul grew from a recognition that efforts to ease the debt problem were being hindered by some unfavorable, unexpected developments. The robust U.S. recovery did not endure, commodity prices remained flat, and the expected flows of new money did not come forth from the commercial banks.
All of this has left the highly indebted nations turning in a vicious circle. Their heavy debt service obligations take away resources needed for domestic investment. The resulting shortfall of investment activity precludes a significant expansion of export capacity to generate additional foreign exchange. Debt payments remain an overwhelming burden, which in turn diminishes economic prospects and investor confidence. Commercial banks shy away and domestic capital flies off to more hospitable climes. And as a result—there is no economic growth.

Our discussions in Seoul have put the issue sharply in focus: without new sources of capital the highly indebted countries will fall deeper into a low investment—low growth trap. In order to escape that trap, the heavily indebted countries will need cooperative, concerted action from all participants in an expanded international debt strategy. This means that the indebted countries themselves, the industrial countries, the commercial banks, and the multilateral development banks each have their respective responsibilities. The World Bank takes its role very seriously.
But I want to point out that the sense of urgency on the debt problem did not originate in Seoul. Well before that meeting we had put together creative lending programs for several of the highly indebted Latin American countries. In Colombia, for example, we supported the government's trade liberalization initiative with a $300 million quick disbursing loan, and our monitoring of Colombia's trade policies is associated with the provision of new money by commercial banks. We have forged similar cooperative lending arrangements with Costa Rica, Chile, and Uruguay.

Building on this firm base of recent experience, our work on the debt issue has accelerated sharply.

We are pressing ahead with extensive planning and analysis activities. We are redeploying staff to enhance our capabilities as our coordinating function in the debt strategy grows. We are more directly engaging commercial banks in the process and more aggressively entering into discussions with our borrowers. And let me assure you that our coordination with the IMF is being developed even further. The will to secure this on both sides of Nineteenth Street is very great indeed.
Our special capability in this enhanced international strategy lies in our close relationship with the countries themselves. Through years of lending operations and our enduring policy dialogue on the most sensitive of economic issues, we are well placed to help these countries work out the necessary capital requirements and the needed economic policy changes. Three basic areas must be addressed—first, an increase in the rate of growth of savings, both in the private and public sector. Without new domestic savings, productive new investment will be very difficult to attain. Second, there must be an improvement in economic efficiency, particularly in the use of capital, if a high growth strategy is to be affordable. And finally, exports must increase in order to win back the creditworthiness which has ebbed away in recent years.

To take one specific example from the many countries we are actively working with, Argentina must cope with some daunting problems. Interest payments on external debt now absorb some 40 percent of gross domestic savings compared to less than 5 percent in the early 1970s. While that external debt increased, domestic production actually declined. This meant that by 1985, real GDP per capita in Argentina was 13 percent below the 1974 level. Investment had fallen off too, from 21 percent of GDP in 1974 to 13 percent last year.
What can Argentina do to reverse this decline? First, a continuation of its policy of monetary and fiscal reform is a necessary precondition for any program. Second, positive economic growth must be restored. Third, per capita consumption must steadily improve in order to maintain the social and political consensus behind the program. And last, the ratio of debt to exports must be brought down to levels where foreign capital will be willing to play a more normal role in the economy.

We are engaged in a vigorous dialogue with Argentina and we are fully confident that an enhanced financial relationship will ensue, perhaps not dissimilar to our evolving work with Ecuador.

Earlier this month, we signed two significant growth-oriented adjustment loans to Ecuador. These are the first in a series of loans which will strengthen that nation's ability to secure growth, to enhance domestic economic efficiency and, over time, create a far greater capacity to manage external debt obligations.

When I visited several Latin American nations last month, I came away convinced that the willingness to make the tough political, social and economic decisions is there! Indeed, our discussions with those indebted country governments are progressing well. But because so much of what we do must remain confidential, all I can say to you for now is this: the results of our current activities will become increasingly, publicly evident over the coming months.
But I will make two very important points here. The first concerns the mechanics of our negotiations -- they are "country-by-country." Each indebted nation has its own distinctive situation which requires highly customized attention. Today's debt problems will not be erased with a single sweeping gesture. Solutions will only be found step-by-step and case-by-case.

My second point on country negotiations concerns patience. Adjustment lending on the scale we envision and in association with the thorough economic restructuring that will be required will not be embraced or arranged overnight. Our experience in this sort of operation is well developed, and we have found that sovereign nations negotiate such loans with extreme care. They face political and economic dilemmas just as sensitive and just as intractable as those which we face right here in our own country.

So let us not build up naive expectations. We do have the will of the leaders of most of these nations to act swiftly, but political realities demand time for the process to unfold. If we push for "instant" results and "swift" conclusions, we will risk an impasse that will be damaging for all: damaging to the hopes for recovery in the countries themselves and damaging to the high quality of our lending which our shareholders and investors have come to regard so highly.
Let there be no question that our negotiations with borrowers will proceed on an urgent basis, but we must insist that the pace be measured and the results be of the highest quality.

The World Bank's coordinating role has also involved us in frequent discussions with commercial bankers who, as you know, are very key players in this cooperative strategy. We feel that the willingness of the commercial banks to provide more financing to the indebted countries will rest very squarely on the progress of adjustment in the indebted countries, the quality of that adjustment, and its orientation to growth. My discussions with both bankers and developing country leaders (in recent weeks) make me confident that the required cooperation will be obtained.

Thus, The World Bank is geared up to play three distinct roles in this expanded international debt strategy. First, we will be assisting in the formulation of country growth programs and will be helping in the monitoring of their progress. Second, we will be providing a growing volume of loans necessary to support the programs. Third, we will be acting as a catalyst in the mobilizing of capital from other sources. This work is well underway, and in the next few months time you will hear more results.
It might seem from all the recent attention paid to the problem of the highly indebted nations/that The World Bank has given up its project lending in the rest of the middle-income countries. This, of course, is not the case! Our market-rate lending operations to the more creditworthy nations is another key priority on our agenda. From China to Turkey to Indonesia and Tunisia/our lending activities are moving ahead. Indeed, overall we see our total commitments to all middle income nations this year (dollars—probably reaching the upper 3/4 of that range . . .) totalling between $12 to $13.5 billion compared to $11.4 billion achieved last year. And our work in progress leaves little doubt that in our next fiscal year/still higher levels of commitments will be reached.

This growth in the Bank's lending will continue, and before long, we will face limitations on that growth imposed by the amount of our capital and reserves. I would like to point out to this influential audience, that the World Bank will need within the next several years a general capital increase. We shall need additional capital to support our expanding activities.
Let me turn now to the World Bank's concessional financing affiliate, IDA. As you all know, IDA lends to the poorer, less creditworthy developing countries, at no interest and with 50-year maturities on its credits. It is no secret to this audience that the replenishment of IDA's resources has not always been trouble-free. IDA's donor nations agreed to a $9 billion dollar replenishment for fiscal years 1985, '86, and '87, in 1984, a sum $3 billion less than the previous three-year replenishment and a disappointment, not only for IDA's borrowers (in Africa and Asia) but for many donors as well. At the conclusion of those negotiations, there was a palpable sense (among donors) of a job not fully done.

Africa's relentless economic decline has been a grim reminder of the need for a strong IDA, and early last year donors established the Special Africa Facility as a response to the crisis and as a de facto supplement to IDA VII. The Facility, which makes available fast disbursing concessional credits in support of economic adjustment and reform, operates with terms and procedures almost identical to IDA.

To date $1.4 billion has been pledged to the Facility, including a welcome appropriation of $75 million from the United States. The generous donor response to the Africa Facility holds out the hope that "aid fatigue" may itself be exhausted. It seems to indicate that a more favorable attitude may be developing toward concessional flows.
This week in Paris, the IDA deputies met for the first time to consider the eighth replenishment of IDA. They concluded their meeting earlier today, and I have some encouraging news to report to you.

After three days of discussions on the size of the replenishment, IDA's lending terms, and the geographical distribution of its lending, there was positive progress and a convergence of views on these matters.

The deputies were able to establish a strong framework for future rounds of the negotiations, and most importantly, they all were in agreement that they should consider a replenishment of $12 billion. The specific figure which will eventually be decided on will depend (to a certain degree) on the decisions taken on other issues, notably the terms and conditions of IDA credits and their geographical distribution.
These are difficult issues, but we are pleased with the progress achieved. Indeed, we believe that sufficient momentum has been created to complete the negotiations before the World Bank's next annual meeting in the fall.

This is a good beginning, but we must realize that there is a long way to go. It is our hope that the final outcome will respond to the simple fact that the resources we now have, through IDA VII and the Africa Facility, fall seriously short of what is needed by the poorest countries. In Africa the demand for special adjustment finance is much longer term than the three-year life of the Africa Facility. And in addition to the investments needed in human resource development, poverty alleviation and basic infrastructure, one of IDA's more urgent tasks will be to address the emerging debt problems of many poorer countries in the developing world. By building on the encouraging framework established in Paris, we look forward to an eighth replenishment of IDA which will respond to the needs of all of our poorer country members.

On another front, Secretary Baker has outlined ideas for additional concessional flows in association with the IMF Trust Fund. We are working hard to help develop this most constructive initiative. In Paris, the IDA donors agreed that, once the Boards of the Fund and the Bank act favorably on the Trust Fund, they could foresee some of IDA's resources being used in association with the IMF Trust Fund.
IDA's replenishment and the Bank's full response to the needs of our middle-income countries are two of our highest priorities, but they are closely followed by issues crucial to the future of private sector development -- that is the future of MIGA and the IFC.

Last year, we were very gratified with the decision of our Board of Governors to approve the convention establishing the Multilateral Investment Guarantee Agency (or MIGA). MIGA will be part of The World Bank family and will promote private investment for development through its coverage against the risks of adverse currency situations, political violence, and expropriation. Through these coverages and an array of advisory and intermediary services, we expect MIGA to substantially improve the private investment climate in participating developing countries.
To bring the MIGA convention into force, we will need the signatures of five industrialized countries and fifteen developing nations. This is an endeavor which already has involved many of the governments represented in this room, and I want to emphasize how important it is that we receive your active support of MIGA. Six developing countries (Korea, Turkey, Ecuador, Senegal, Sierra Leone, and St. Lucia) have already signed the convention, but more of course are needed. The United States has announced its intention to seek Congressional authorization of U.S. participation in MIGA; and we expect the Administration to move in the near term. The sooner we are able to obtain the necessary signatures, the sooner MIGA will contribute to the revival of foreign investment in the developing world.

Our commitment to private sector development doesn't stop with MIGA. We have a private sector affiliate, the International Finance Corporation (IFC), which as you know, lends or invests directly in private sector enterprises. The IFC is rapidly expanding its activities in the developing world, now that the countries holding more than 90% of its shares have IFC's Board has approved a doubling of its capital to $1.3 billion. The major industrial country shareholders of the IFC are making good progress in pushing through their subscriptions to the capital increase, including a $29 million first installment from the United States.
We are pleased with this progress but it doesn't mean we can rest easy. In the case of the United States, the Gramm-Rudman-Hollings procedures recently enacted by Congress will certainly be a factor in further installments. Budgetary constraints are a problem among other shareholders as well. We nonetheless must make clear how important it is to maintain the commitment to contribute the full allocation of IFC's capital increase, especially here in the United States, even if it means stretching out payments somewhat to meet budgetary targets. As in the case of MIGA, the role must be one of unquestioned leadership in the expansion of IFC's capital, and we believe our largest shareholder will fulfill our high expectations.

Ladies and gentlemen, I have set before you today the priority issues on The World Bank's agenda as we see them. Against a backdrop of an uncertain economic climate in the industrial countries no one in this room can underestimate the degree of difficulty we and our developing country partners face in these challenges. But it is reassuring that among our major shareholders there seems to be a growing recognition of the capabilities of The World Bank and a determination to employ them fully, whether it be in new efforts to deal with Third World debt, in helping the very poorest nations to emerge from poverty, or in expanding our role in private sector development. We think we deserve that recognition, and we are eager to perform the major roles which are before us.
But one very crucial factor remains uppermost in our minds -- the continuing encouragement and support we must receive not only from our shareholders, some of whom are represented here today, but also from key members of the American community such as those who are gathered here in this room. I hope we will continue to have you all on our team -- indeed we are counting on it.

Thank you. And now I will be pleased to hear your comments and questions.